Leasing Activities Information

MMS

U.S. Department of the Interior
Minerals Management Service
Alaska OCS Region

Royalty Suspension Provisions
Beaufort Sea Oil and Gas Lease Sale 186

In accordance with applicable regulations at 30 CFR 260, the following royalty suspension provisions apply to Beaufort Sea Oil and Gas Lease Sale 186. The zones in which blocks are located are indicated on the Block List and on the map included in the Notice of Sale package available from the MMS Alaska Region office.

These Royalty Suspension Provisions apply to first Oil Production. Gas production is not subject to Royalty Relief. In addition, refer to 30 CFR 218.151 and applicable parts of 260.120-260.124 for regulations on royalty suspensions and rental obligations that will apply to your lease.

1) A lease in the Beaufort Sea, depending on surface area and zone, will receive a royalty suspension volume (RSV) as follows:

Hectares	Zone A Million Barrels RSV	Zone B Million Barrels RSV
770 or less	10	15
771-1540	20	30
1541 or above	30	45

2) The RSV only applies to liquid hydrocarbon production, i.e., oil and condensates. Natural gas volumes that leave the lease are subject to original lease-specified royalties. The market value, if any, of natural gas will be determined by MMS's Minerals Revenue Management (MRM) office. The MRM will value the natural gas from Sale 186 based on its actual or potential uses and applicable market characteristics at the time the gas is produced.

3) The lessee must pay royalty on production that would otherwise receive royalty suspension from automatic relief (in 30 CFR 260) and such production will count towards the royalty suspension volume, in any calendar year during which the arithmetic average of the daily closing prices for the nearby delivery month on the New York Mercantile Exchange (NYMEX) for oil exceeds the adjusted upper product price threshold (or "ceiling price").

a) The adjusted upper price threshold for light sweet crude oil in any year, say *t*, is determined by inflating an oil price of $28 per barrel beginning in base year 1994. This base year price is modified by the percentage change in the implicit price deflator for the interval between 1994 and year *t*, resulting in the adjusted oil price threshold for year *t*. For example, if the deflator from 1994 through 2003 indicates that inflation totaled 15 percent, then the adjusted price threshold (ceiling) in calendar year 2003 would become $32.20 per barrel for oil. Royalty on all oil production in calendar year 2003 would be due if the 2003 average NYMEX oil price exceeded $32.20 per barrel.

b) The MMS will provide notice when adjusted price thresholds (ceilings) are exceeded. Also, information on price thresholds is available at the MMS website (www.mms.gov/econ).

c) In cases where the actual average price for the product exceeds the adjusted ceiling price in any calendar year, royalties must be paid in the following calendar year. (See 30 CFR 260.122 (c) for more detail.)

4) A fixed oil price floor applies, below which oil and condensate would be produced both royalty-free and would not count against the RSV. As long as any RSV remains for use, if the arithmetic average of the daily closing oil prices for "the specified time period," i.e., a calendar quarter, is below the price floor, then any oil and condensate produced during that time period would be royalty-free and would not be subtracted from the lease's remaining RSV. If the arithmetic average of the daily closing oil prices is below the floor price after the original RSV is exhausted, the lessee receives no additional royalty-free production.

a) The price floor for light sweet crude oil is set at a fixed $18 per barrel with no adjustment for inflation. The comparison with the price floor is calculated from the arithmetic average of the daily closing prices for the **"nearby delivery month"** on the NYMEX for light sweet crude oil with no adjustments for inflation. The period of assessment is a quarter of a calendar year with the calendar year quarters being January-March, April-June, July-September, and October-December.

b) The MMS will provide notice when the average NYMEX quarterly oil price for the previous quarter is below the $18 per barrel floor price. If so, then production for the quarter will not count against the remaining RSV. Also, information on the oil price floor will be available at the MMS website (www.mms.gov/econ).

5) The price ceiling and floor provisions in items 3 and 4 above expire in the period following the one in which the lease's original RSV amount has been exhausted. The specified time period is quarterly for the price floor and yearly for the price ceiling.[1]

---

[1] There is a low probability that in one year, oil prices could be below the price floor for one quarter, but the average oil price for the full year could be above the price ceiling. If that were to occur and the lease had not exhausted its RSV, in any quarter in which the average oil price is below the price floor, the oil and condensate production in that quarter would be royalty-free and would not count against the RSV. However, if the price

6) For purposes of the RSV, a lease that is part of an approved unit agreement can only apply allocated production from the unit against the lease's RSV if that lease is included in an approved participating area. The RSV will be applied to each lease consistent with the allocation schedule approved by the MMS for the participating area.

---

ceiling for the year was exceeded, the oil and condensate production from the remainder of the year would be subject to royalty and would be subtracted from the remaining RSV. For example, assume that production for a lease for a year is 10 million barrels. If production during the quarter when the average price was below the floor was 2 million barrels, no royalty would be due on that production and it would not affect the remaining RSV. However, royalty would be due on the remaining 8 million barrels of production from the rest of the year and that production would reduce the RSV.